LIBRARY
SUPREME COURT, U.S.

Office - Supreme Court, U. S.
FILED
FEB 2 1955
HAROLD B. WILLEY, Clerk

No. 114

In the Supreme Court of the United States

OCTOBER TERM, 1954

GENERAL AMERICAN INVESTORS COMPANY, INC.,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

SIMON E. SOBELOFF,
Solicitor General,
H. BRIAN HOLLAND,
Assistant Attorney General,
CHARLES P. HARNER,
ELLIS N. SLACK,
MELVA M. GRANEY,
Special Assistants to the Attorney General,
Department of Justice, Washington 25, D. C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and Regulations involved	2
Statement	6
Summary of argument	8
Argument:	
The insider profits paid over to it in 1948 constituted taxable income to taxpayer under Section 22 (a) of the Internal Revenue Code of 1939	10
Conclusion	18

CITATIONS

Cases:	
Commissioner v. *Glenshaw Glass Co. and William Goldman Theatres, Inc.*, No. 199, O. T. 1954	11, 12, 13, 14, 15
Davis, William F., Jr., 17 T. C. 549	17
Eisner v. *Macomber*, 252 U. S. 189	9, 10, 13, 14, 15, 17
Helvering v. *Bruun*, 309 U. S. 461	14, 15
Park & Tilford Distillers Corp. v. *United States*, 107 F. Supp. 941, certiorari denied, 345 U. S. 917	11, 18
Rutkin v. *United States*, 343 U. S. 130	15, 17
Texas & Pacific Ry. Co. v. *United States*, 286 U. S. 285	12
United States v. *Kirby Lumber Co.*, 284 U. S. 1	15
Statutes:	
Internal Revenue Code of 1939, Sec. 22 (26 U. S. C. 1952 ed., Sec. 22)	8, 9, 11, 12, 13, 14
Investment Company Act of 1940, c. 686 54 Stat. 789, 836, 837, Sec. 30 (15 U. S. C. 1952 ed., Sec. 80a–29)	3, 11
Securities Exchange Act of 1934, c. 404, 48 Stat. 881, 896, Sec. 16 (15 U. S. C. 1952 ed., Sec. 78 p)	3, 9, 11, 15, 16

Miscellaneous: Page

Cook and Feldman, *Inside Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385 (1953) 16, 17

Darrell, *The Tax Treatment of Payments under Section 16 (b) of the Securities Exchange Act of 1934*, 64 Harv. L. Rev. 80, 94–95 (1950) 12

H. Rep. No. 1383, 73d Cong., 2d Sess 16

I. T. 4069, 1952–1 Cum. Bull. 28 17

S. Rep. No. 792, 73d Cong., 2d Sess 16

Treasury Regulations 111:

Section 29.21–1 5

Section 29.22 (a)–1 6

In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 114

GENERAL AMERICAN INVESTORS COMPANY, INC.,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Court of Appeals (R. 13–18) is reported at 211 F. 2d 522. The findings of fact and opinion of the Tax Court (R. 3–12) are reported at 19 T. C. 581.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1954 (R. 19). The petition for a writ of certiorari was filed on June 4, 1954, and was granted October 14, 1954 (R. 26). The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

QUESTION PRESENTED

Two individuals, one a director and the other a stockholder of the taxpayer-corporation, derived insider profits from short-term trading in taxpayer's stock which they paid over to taxpayer pursuant to the requirements of Section 30 of the Investment Company Act of 1940 and Section 16 of the Securities Exchange Act of 1934. The question presented is whether the amount of those profits paid over to taxpayer in 1948 constituted income to taxpayer under Section 22 (a) of the Internal Revenue Code of 1939.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 22.)

Investment Company Act of 1940, c. 686, 54 Stat. 789, 836, 837:

> SEC. 30. * * *
>
> * * * * *
>
> (f) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered closed-end company is the issuer or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by section 16 of the Securities Exchange Act of 1934 upon certain beneficial owners, directors, and officers in respect of their transactions in certain equity securities.
>
> (15 U. S. C. 1952 ed., Sec. 80a–29.)

Securities Exchange Act of 1934, c. 404, 48 Stat. 881, 896:

> SEC. 16. (a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he

becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (*and a duplicate* original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court

of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

* * * * *

(15 U. S. C. 1952 ed., Sec. 78p.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.21-1. *Meaning of Net Income.*— The tax imposed by chapter 1 is upon income. * * * In the computation of the tax various classes of income must be considered:

(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. * * *

(b) Gross income, meaning income (in

the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by chapter 1. (See section 22.)

(c) Net income, meaning gross income less statutory deductions. * * *

* * * * *

SEC. 29.22(a)-1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * * *

STATEMENT

The facts were stipulated (R. 23–26) and found by the Tax Court as stipulated (R. 3). They may be summarized as follows:

Taxpayer is a corporation organized under the laws of the State of Delaware and has its principal office in New York. Its 1948 federal income tax return was filed for the calendar year and on the accrual basis. (R. 23.)

On or about April 1, 1944, one of taxpayer's directors (hereinafter referred to as "Director") acquired warrants to purchase 12,228 shares of

taxpayer's common stock at five different prices ranging from $10 to $20 a share. On the same date another individual (hereinafter referred to as "Stockholder") acquired warrants of the same type to purchase 27,027 shares of taxpayer's common stock. On December 4 and 18, 1945, the Director and Stockholder both exercised their warrants by purchases of taxpayer's stock at an average purchase price of $13.75 a share. They both sold the stock on the New York Stock Exchange prior to June 17, 1946, in blocks of various sizes and for various amounts. (R. 23–24.)

Pursuant to the provisions of Section 30 (f) of the Investment Company Act of 1940 and Section 16 (b) of the Securities Exchange Act of 1934, the Director and Stockholder were required to pay over to taxpayer the profits which they had realized on the above-described purchases and sales of the common stock of taxpayer. The profits of the Director were computed to total $81,092.33, which was the amount by which the proceeds received on the sale of 27,027 shares of stock ($254,027.33) exceeded the aggregate cost of the warrants to purchase the stock ($4,800) and the aggregate subscription price paid for the stock ($168,135). The profits of the Stockholder were similarly computed to total $129,362.95. (R. 24–25.)

On January 26, 1948, taxpayer was paid a total of $170,038.04 of such profits—$129,362.95 by the Stockholder and $40,675.09 paid by the Director

(R. 25). Those amounts were received by taxpayer without litigation (R. 25) but taxpayer expended $13,000 as legal fees in connection with their recovery (R. 6, 25). The Director and Stockholder paid the amounts upon the advice of their counsel that they were liable to taxpayer therefor (R. 25).

Taxpayer did not report the $170,038.04 as income in its 1948 income tax return. The Commissioner determined a deficiency against taxpayer for 1948 on the ground that $157,038.04 thereof (the $170,038.04 less legal expenses of $13,000) constituted realized gain taxable to petitioner under Section 22 (a) of the Internal Revenue Code (R. 3). The Tax Court upheld the Commissioner's determination (R. 6–12) and the Court of Appeals affirmed (R. 13–18).

SUMMARY OF ARGUMENT

Section 22 (a) defines "gross income" to include "gains or profits and income derived from any source whatever." This language, as consistently interpreted by this Court, plainly declares subject to tax all gain received by a taxpayer, except such gain as has been by law specifically exempted by tax. It is undisputed that the receipt by taxpayer of the "insider profits" here in issue represented realized gain. Taxpayer had unrestricted discretion to use these funds for any purpose whatsoever and they were in no sense contributions to, or returns of, capital. Nor is it suggested that they were exempt from tax as

gifts. It follows that the receipts must be included in gross income under Section 22 (a).

Taxpayer's contention that the payments did not constitute income is based on the definition of income used by this Court to distinguish income from capital in *Eisner* v. *Macomber*, 252 U. S. 189, 207—"the gain derived from capital, from labor, or from both combined." Its argument is premised on the untenable assumption that the Code "makes no attempt to define income" and that the *Eisner* v. *Macomber* definition is essential lest the determination of what constitutes income be left to "judicial hunch."

But Section 22 (a) explicitly defines income. Since the statutory definition is clear and plainly covers the receipts here in issue, there is no occasion to improvise any other guiding rule for the determination of what constitutes income. In any event, as many decisions of this Court indicate, the *Eisner* v. *Macomber* definition is not controlling in determining what constitutes income under Section 22 (a).

Of course, most gain, including Section 16 (b) payments, can be said to be derived from capital or labor or both. The "insider profits" here in issue were received by taxpayer in the lawful conduct of its business. Section 16 (b) is based on the principle that the confidential information which a corporate insider obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the

insider is made liable directly to the corporation and indirectly to all its shareholders for the profits he realizes. Receipt of the gain, moreover, required effort on the part of the corporation to collect it. Taxpayer's contention that it did nothing to perfect its rights to the payments is untenable in view of the fact that it paid $13,000 in legal fees for services rendered in connection with the recovery of the sums due.

Whether we look for guidance to the plain words of the statute or to the gloss derived from the *Eisner* v. *Macomber* definition, the receipts of "insider profits" constituted taxable income. Congress has been articulate in exempting receipts which it intended should not be taxed as income. There is no room for the creation by judicial construction of new non-statutory exceptions to Section 22 (a).

ARGUMENT

THE INSIDER PROFITS PAID OVER TO TAXPAYER IN 1948 CONSTITUTED TAXABLE INCOME TO TAXPAYER UNDER SECTION 22 (a) OF THE INTERNAL REVENUE CODE OF 1939

This case presents the issue whether certain receipts—"insider profits"—which constituted realized gain to taxpayer and are not specifically exempted from tax are taxable to taxpayer under Section 22 (a) of the Internal Revenue Code of 1939. The decision below follows the decision of the Court of Claims in *Park & Tilford Distillers Corp.* v. *United States*, 107 F. Supp. 941, certi-

orari denied, 345 U. S. 917, where such receipts were held taxable under Section 22 (a) as "gains or profits and income derived from any source whatever." A comparable issue is presented in *Commissioner* v. *Glenshaw Glass Co. and William Goldman Theaters, Inc.*, No. 199, this Term, which involves the taxability of punitive damages. Inasmuch as our position is fully stated in our brief and reply brief in *Glenshaw*, to which the Court is respectfully referred, our brief herein will be limited to a summary statement of our position, together with such further matters as are indicated by the somewhat different circumstances of this case and the arguments advanced in taxpayer's brief.

Section 22 (a) of the Internal Revenue Code of 1939 defines "gross income" to include "gains or profits and income derived from any source whatever." This language, as consistently interpreted by this Court, plainly declares subject to tax all gain received by a taxpayer, except such income or gain as has been by law specifically exempted from tax. The issue here concerns the taxability of "insider profits" paid over to taxpayer in 1948, pursuant to Section 30 (f) of the Investment Company Act of 1940 and Section 16 (b) of the Securities Exchange Act of 1934.

It is undisputed that these payments represented realized gain to taxpayer. As noted by the court below (R. 17), taxpayer had unrestricted discretion to use the funds paid over to

it for any purpose whatsoever; they were in no sense contributions to capital,[1] or payments by way of restoration of lost capital, or compensation for any loss suffered by petitioner. Nor were the payments, gifts, or any other type of gain specifically exempted from tax under Section 22 (a), and taxpayer does not argue otherwise. It follows under the plain terms of the statute that the receipts of "insider profits" must be included in "gross income" under Section 22 (a).

Taxpayer apparently recognizes that the statutory definition is constitutional and that the payments here involved constituted gain to it. Its

[1] Taxpayer apparently considers that the insider profits were in the nature of a windfall to the corporation (see Br. 9–11) although it asserts that they "resemble" legally enforced capital contributions and that, in the circumstances of this case, the corporate receipts were "very much akin" to the receipt of part of the subscription price of newly issued shares (Br. 11). The court below properly rejected the contention that the payments were part of the subscription price of newly issued shares (R. 17–18) and taxpayer has not made that contention here. Taxpayer does state that it "would seem especially appropriate" to treat the payments as "capital in nature" as if made pursuant to "the subscription contract itself" (Br. 12). But since the insider profits were not in fact part of the subscription price of stock and were received by taxpayer without any restriction as to their use, they do not fall into the category of a nontaxable capital contribution. See *Texas & Pacific Ry. Co.* v. *United States*, 286 U. S. 285, and pages 39–40 of our brief in the *Glenshaw* case. See further Darrell, *The Tax Treatment of Payments under Section 16 (b) of the Securities Exchange Act of 1934*, 64 Harv. L. Rev. 80, 94–95 (1950).

argument that the payments did not constitute income under Section 22 (a) is based simply upon the definition of income used by this Court in *Eisner* v. *Macomber,* 252 U. S. 189, 207—"the gain derived from capital, from labor, or from both combined." Taxpayer suggests that the comprehensive language of Section 22 (a) is restricted in meaning by what it calls "the source language" or the "source rule" of the *Eisner* v. *Macomber* definition (Br. 21, 23). That suggestion is premised on the patently incorrect statement that Section 22 (a) of the Code "makes no attempt to define income" (Br. 17–18). On this premise, taxpayer urges acceptance of the *Eisner* v. *Macomber* definition lest the determination of what constitutes income be left without any guiding rule other than a "judicial hunch" (Br. 24).

Section 22 (a) does, of course, define income. Section 22 (a) itself is captioned "General Definition." "Gross Income" for the purposes of the Code is defined as including "gains, profits, and income" derived from certain specified sources and, comprehensively, as including "gains or profits and income derived from any source whatever." To the extent that it defines income as including all gains and profits, the statute in unequivocal language prescribes a guiding rule for the determination of what constitutes income. Thus, so far as the present case is concerned, if the

words "gains * * * derived from any source whatever" are given their usual meaning, then, as the court below rhetorically asked (R. 17), "how can there be any doubt that these Section 16 (b) payments are 'income'?"

Since the language of Section 22 (a) is clear, and covers this case, there is no occasion here to improvise any other guiding rule for the determination of what constitutes income.[2] Moreover, it is clear that the *Eisner* v. *Macomber* definition, which was adopted and has been used by this Court for an entirely different purpose, i. e., to distinguish income from capital,[3] does not illuminate the problem. Taxpayer itself has trouble with the *Eisner* v. *Macomber* definition. On the one hand, taxpayer characterizes the definition as "profoundly perceptive" (Br. 20). On the other hand it asserts that the definition is to be "interpreted broadly" (Br. 19), and suggests that all of the

[2] Nor is there any occasion to explore the popular meaning of "income." But we think that the payments here in issue, like the payments of punitive damages in the *Glenshaw* case, would be considered income in the popular sense as well. Periodicity, certainly, is no test of income, as the many decisions of this Court holding non-recurrent receipts to be income attest. See, *e. g.*, cases cited, page 15, *infra*. The payments in issue were received in the course of transaction of a business, they constituted gain in every sense of the word, they were received free of any obligation whatsoever and were not intended to be and were not in fact contributions to capital or return of capital. This is income in the popular sense.

[3] See, *e. g.*, *Helvering* v. *Bruun*, 309 U. S. 461, 468-469.

receipts held by this Court to be taxable under Section 22 (a) could be construed to come "within the broad meaning" and "under a reasonable interpretation" of the "source language" of the definition (Br. 21, 23), including *United States* v. *Kirby Lumber Co.*, 284 U. S. 1 (gain from purchase of taxpayer's own obligations at a discount); *Helvering* v. *Bruun*, 309 U. S. 461 (gain received on forfeiture of lease on which lessee had erected a building); and *Rutkin* v. *United States*, 343 U. S. 130 (gain consisted of extorted money). Thus taxpayer, itself, in order to accommodate the decisions of this Court under Section 22 (a), would nullify the restrictive implications of the "source language" of the *Eisner* v. *Macomber* definition on which it relies. To say that these decisions are reconcilable is merely to recognize that most, if not all, gain can be said to be derived from capital or labor or both. See further our reply brief in *Glenshaw*, at pp. 7–10.

Indeed, the gain here too can be said to be derived from capital and labor. Taxpayer received the payments in the lawful conduct of its business. The payments derived from a lawful claim which constituted a property right. Collection of an obligation created by law would appear to be as much a business transaction as the collection of any other obligation. The lawful claim derived from Section 16 (b). That section was designed "to protect the interests of the pub-

lic by preventing [insiders] from speculating in the stock on the basis of information not available to others."[4] In providing that the insiders' profits must be paid over to the corporation, Congress appears to have been proceeding "on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation."[5] Having availed himself personally of this information, the insider is made liable directly to the corporation and indirectly to all its shareholders for the profits he realizes. The gain may thus be said to have been derived from property belonging exclusively to the corporation. Receipt of that gain, moreover, required effort on the part of the corporation to collect it. Taxpayer's contention that it did nothing to perfect its right to the payments concerned (Br. 9–10) is hardly tenable in view of the fact that it is undisputed that taxpayer paid $13,000 in legal fees in payment for services rendered in connection with the recovery of the sums due (R. 6, 25).[6] Thus the receipts involved here consist of "gain derived from capi-

---

[4] S. Rep. No. 792, 73d Cong., 2d Sess., p. 9; cf. H. Rep. No. 1383, 73d Cong., 2d Sess., p. 13.

[5] Cook and Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 408 (1953). Mr. Cook was at the time chairman and Mr. Feldman special counsel of the Securities and Exchange Commission (*id.*, 385).

[6] The concurring judges in the Tax Court buttressed their conclusion that the Section 16 (b) payments were income under Section 22 (a) with the observation that Section 16 (b) itself terms the payments as "profits" and provides that

tal, from labor, or from both combined" when that phrase is interpreted in the light of present decisions of this Court.[7] The "insider profits" patently had a more direct origin in taxpayer's capital and labor than did, for example, the extorted money held by this Court to be income in *Rutkin* v. *United States,* 343 U. S. 130.

The essential characteristics of the receipts in question are that they constituted realized gain to taxpayer and have not been exempted by Congress from tax. Taxpayer does not contest either of these propositions, which in our view dispose of the case. But whether we look for guidance to the plain words of the statute or to the gloss derived from the definition of income used by this Court in *Eisner* v. *Macomber,* the receipts of "insider profits" here involved constituted taxable income within the broad scope of Section 22 (a). This Court has many times affirmed the comprehensive scope of that section. Congress

---

they "shall inure to and be recoverable by the issuer" (R. 11–12).

[7] This case does not present the question of the tax liability of the insider on his gain, if any, resulting from the security transactions which give rise to liability under Section 16 (b). See I. T. 4069, 1952–1 Cum. Bull. 28; *William F. Davis, Jr.,* 17 T. C. 549; *cf.* Cook and Feldman, *Insider Trading under the Securities Exchange Act,* 66 Harv. L. Rev. 385, 615–617 (1953).

has been articulate in exempting from Section 22 (a) receipts which it intended should not be taxed as income. Although Congress has recently completed a comprehensive revision of the Internal Revenue Code and, as noted by taxpayer, has included in the law certain additional exclusions from income for purposes of the income tax (Pet. Br., p. 22, n. 4), Congress did not seek to disturb the rule of *Park and Tilford Distillers Corp.* v. *United States,* 107 F. Supp. 941 (C. Cls.), certiorari denied, 345 U. S. 917, that "insider profits" are taxable as income to the recipient corporation. And as we have demonstrated, there is no sanction for the creation of new nonstatutory exceptions to Section 22 (a) by a process of judicial construction.

CONCLUSION

The decision below is correct and should be affirmed.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
CHARLES F. BARBER,
ELLIS N. SLACK,
MELVA M. GRANEY,
Special Assistants to the Attorney General.

FEBRUARY 1955.